No. 11999

In the United States Court of Appeals for the Ninth Circuit

HARRY A. ROBERTS AND RUTH M. ROBERTS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 12-18) are reported at 10 T. C. 581.

JURISDICTION

This petition for review (R. 19-22) involves federal income taxes for the taxable year 1943. On May 29, 1946, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency in the total amount of $144.34. (R. 6.) Within 90 days thereafter, and on August 21, 1946, the taxpayer filed the petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 3-5.) The decision of the Tax Court sus-

taining the deficiency was entered April 2, 1948. (R. 19.) The case is brought to this Court by a petition for review filed June 24, 1948 (R. 19-22), pursuant to the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Were tips received by the taxpayer, a cab driver, in 1943, "compensation for personal service" and thus taxable income under the provisions of Section 22(a) of the Internal Revenue Code?

2. Did the Tax Court properly sustain the Commissioner's determination that taxpayer's tips received in 1943 were conservatively 10 per cent of his gross fares?

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid. * * *
>
> * * * *
>
> (26 U. S. C. 1946 ed., Sec. 22.)*

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> SEC. 29.22(a)-2. *Compensation for Personal Services.*—Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, * * *.

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* This was amended by the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574, in respects not here involved.

STATEMENT

The facts as found by the Tax Court are as follows in so far as pertinent to this appeal (R. 12-13):

The petitioners are husband and wife. They filed a joint federal income tax return for the taxable year with the Collector for the Sixth District of California. During the taxable year the petitioner, Harry A. Roberts (hereinafter referred to as taxpayer), was employed as a taxicab driver by the Yellow Cab Company of California, in Los Angeles. During the year he received from patrons sums of money, ordinarily called "tips," in addition to the regular established fare for the transportation of patrons. He kept no record thereof. About 50 per cent of passengers tipped. He had instructions, in his contract with the Yellow Cab Company, not to solicit tips, was forbidden to do so, and did not do so. He was allowed to charge only what the taxicab meter showed. In his contract incidental service, such as, carrying of bags, was included in the wages received. His wages were, in 1943, 45 per cent of the take, or $6 a day, whichever was greater. He worked in 1943 about 240 to 250 days. A 50 cent fare is typical, and the usual tip therefor is 10 cents. It is the same for an 80 cent fare. A $1 fare usually does not carry a tip. On a 30 cent fare the tip is usually 10 cents, sometimes 15. The average fare is about 80 cents. On $10, $5, or $3 trips there is usually no tip. On a $15 or $20 trip, which is uncommon, the average tip would be 25 to 50 cents. There would be five or six $5 trips, and not more than one $10 trip in a month. He conveyed passengers under charge accounts also and those who used Yellow Cab script, from whom no tips were received. The year 1943 was better than average; gasoline rationing approximately trebled the number of

taxicab patrons so far as tips were concerned. A tip is rarely less than 10 cents. Tips average, conservatively and reasonably, 10 per cent of gross bookings. Tips were more liberal during war time than in ordinary times.

SUMMARY OF ARGUMENT

Tips were given to taxpayer, a cab driver, as a method of compensating him for service properly rendered. No evidence was introduced which would indicate the existence of a "donative" intent, nor would the relationship between cab driver and passenger indicate such intent. A cab driver expects to receive something extra for his service, and the passenger expects to pay it. Being a form of compensation, tips are taxable income under Section 22(a) of the Internal Revenue Code and have been held to be taxable income under the Regulations promulgated by the Commissioner over the last thirty years.

Since taxpayer kept no records of tips received, the Commissioner, after investigation, determined the taxpayer's tips were conservatively 10 per cent of his gross fares. The Tax Court sustained this determination, and the evidence in support of the Tax Court's finding was abundant. Since the finding was not clearly erroneous, it should not be disturbed on appeal.

ARGUMENT

I

Tips received by the taxpayer, a taxicab driver, during the year 1943 are taxable income within the meaning of Section 22(a) of the Internal Revenue Code

Section 22 (a) of the Internal Revenue Code, *supra,* defines gross income as follows:

> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from sal-

aries, wages, or *compensation for personal service,* * * * (Italics supplied.)

It is difficult to conceive of anything that might more appropriately be characterized as "compensation for personal service" than tips customarily given to cab drivers, bellboys, waiters and the multitude of those whose livelihoods similarly depend on the rendering of personal service to the public. To insist that tips constitute gifts as distinguished from compensation merely because they represent sums which the driver is forbidden to solicit, and which the passenger is not legally required to pay, is to ignore the essential nature of the practice of tipping. It is very well established that the mere absence of a legal obligation to pay is not determinative; and, indeed, cases are numerous in which voluntary payments to employees for past service have been held to be compensation, often where the payments were deferred until substantially after the services were rendered. *Schumaker* v. *United States,* 55 F. 2d 1007 (C. Cls.); *Old Colony Tr. Co.* v. *Commissioner,* 279 U. S. 716; *Botchford* v. *Commissioner,* 81 F. 2d 914 (C.C.A. 9th). See Magill, Taxable Income (Rev. ed. 1945), p. 402.

One can hardly question the causal relationship between the rendering of service by the taxpayer and the payment of tips. The tips are paid contemporaneously with the payment of the fare and are to a certain extent proportional to the amount of the fare. It is apparent that the size of the tip is substantially dependent upon the efficiency and courtesy with which the service is rendered; and, as the Tax Court indicated, one's imagination need not be strained to visualize the probable deterioration in service resulting if passengers ceased to tip. The practice of tipping is simply a common

method of compensating those who satisfactorily render personal service. On the other hand, tips represent a substantial and anticipated source of income to cab drivers, waiters, etc. In short, the passenger in a cab expects to pay a little extra for good service; and the driver expects to receive a little extra.

Moreover, because tips are an anticipated source of income, they are a significant factor in fixing the wages of those engaged in personal service occupations. If the practice of tipping were abolished, the ultimate result would be simply an increase in the wages of the cab driver, which would, of course, be reflected in the fare paid by the passenger.

It is precisely for these reasons that tips have been consistently held to be "compensation for personal service" and thus taxable income under the Regulations. Regulations 111, Section 29.22(a)-2, *supra,* defines "compensation for personal service" as follows:

> *Compensation for Personal Services.*—Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, * * *.

Similarly, tips have been classified as compensation in all corresponding Regulations promulgated over the last three decades. Regulations 103, Section 19.22(a)-2, promulgated under the Internal Revenue Code; Regulations 101, Article 22(a)-2, promulgated under the Revenue Act of 1938; Regulations 94, Article 22(a)-2, promulgated under the Revenue Act of 1936; Regulations 86, Article 22(a)-2, promulgated under the Revenue Act of 1934; Regulations 77, Article 52, promulgated under the Revenue Act of 1932; Regulations 74, Article 52, promulgated under the Revenue Act of 1928; Regulations 69, Article 32, promulgated under the

Revenue Act of 1926; Regulations 65, Article 32, promulgated under the Revenue Act of 1924; Regulations 62, Article 32, promulgated under the Revenue Act of 1921; Regulations 45 (1919 ed.), Article 32, promulgated under the Revenue Act of 1918.

It is hardly necessary to reiterate the familiar principle that these Regulations are entitled to serious consideration, especially since the pertinent language of what is now Section 22(a) of the Internal Revenue Code has been continually re-enacted without material change during the 30-year period in which the above Regulations have been in existence. *Coast Carton Co.* v. *Commissioner,* 149 F. 2d 739 (C.C.A. 9th).

The issue of the taxability of tips as income has not, in the past, been presented to the appellate courts, nor has it been directly presented to the Tax Court until very recently. However, to the extent that the general problem of tipping has been directly or indirectly before the Tax Court, the opinions of the Tax Court have uniformly indicated that tips are a form of compensation. In the case of *Cesanelli* v. *Commissioner,* 8 T. C. 776, the Tax Court sustained the imposition of a fraud penalty against the taxpayer, a waiter, for failure to report the full amount of tips received. Although it is true that the taxpayer did not consider the question of the taxability of the tips as income of sufficient merit to raise the issue, the Tax Court must have concluded that they were taxable income, since the taxpayer would otherwise have not been guilty of fraud in failing to report and pay taxes on them. In the case of *Bateman* v. *Commissioner,* 34 B.T.A. 351, the Board of Tax Appeals held that tips paid by the taxpayer to shipping clerks and railroad and steamship employees were deductible as business expenses under Section 23(a)(1)

(A) of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 23). The decision required the conclusion that tips were not gifts but were compensation for services rendered. In the case of *Foster* v. *Commissioner,* decided February 27, 1948 (1948 P-H T.C. Memorandum Decisions Service, par. 48,024), the Tax Court had presented to it directly the question of the taxability of a cab driver's tips as income and decided, as here, that tips were compensation and taxable income.

The Government is in agreement with taxpayer that *Herberts* v. *Laurel,* 58 Cal. App. 2d 684, which taxpayer cites at some length (Br. 10), "has no application." The issue there was whether tips constituted gross receipts of the business, not whether they were compensation to those who received the tips. The additional authorities cited by taxpayer have been carefully examined, and none appear to support in any way the contention that tips such as those here received are gifts.

Taxpayer's research on the etymology of the word "tip" has led to conclusions of dubious significance. He has ascertained that in Sixteenth Century England and Europe, tips were a kind of alms or present, given by the nobility to serfs and other inferiors. It is difficult to perceive what bearing this has on the nature of tips and the practice of tipping in modern Los Angeles, especially since the nature of tipping is a matter of common knowledge. Taxpayer, however, concludes that tips are often given by passengers as a mark of superiority over the cab drivers, rather than as a compensation for personal service. It is, perhaps, a matter of common knowledge that taxpayer's view of the nature of a tip is not generally shared by cab drivers as a class.

Taxpayer while pointing out that the definition of tip in Webster's Dictionary is not helpful since it defines tip as both a gift and a fee, sets forth the definitions in the Oxford Dictionary and the New Century Dictionary as authority. (Br. 9.) The Oxford Dictionary defines tip as a "gratuity or fee". The definition set forth from the New Century Dictionary begins: "Noun—A sum of money given to secure better or more prompt service." It is not easy to perceive what help taxpayer hopes to receive from these citations. The former, of course, defines tip in both senses as a gift and as a fee. The latter indicates that tips are given to insure better service, which would indicate that they are compensation for services. Taxpayer (Br. 11) advances the contention that many people tip because "John Doe did so" and to "save face". It is not the accuracy but the significance of the observation which seems doubtful. That tipping exists largely by the force of custom is agreed. As indicated previously, a cab driver expects to receive a little extra for his services and the passenger expects to pay a little more.

Taxpayer argues (Br. 14) that it is necessary to determine that tips not only are income but that they are taxable income, and that they are not taxable income if they are gifts. The position of the Government has been that the tips received by taxpayer are income because they are patently "compensation for personal service." Payments in compensation are not gifts.

There is nothing in the evidence adduced by taxpayer, or in the relationship itself between cab driver and passenger to indicate the existence of a "donative" intent.

II

The Tax Court properly sustained the Commissioner's determination that tips received by the taxpayer in 1943 were conservatively 10 per cent of the gross fares

Taxpayer admittedly received tips during the year 1943, but kept no record of the amounts received (R. 25), nor did he report any sum as representing tips on his 1943 return (R. 24). The information as to the exact total of the tips received by taxpayer in 1943 was peculiarly within the knowledge of the taxpayer; and it was consequently necessary for the Commissioner to determine by investigation a fair and reasonable estimate of the tips received by taxpayer in 1943. The Commissioner determined that 10 per cent of the taxpayer's gross bookings was a reasonable estimate of the tips received in 1943, and the burden was, of course, on the taxpayer to overcome the presumption in favor of the validity of the Commissioner's determination. In support of his contention that the determination was unreasonable, taxpayer testified that about ½ of his passengers tipped and that the tips amounted to 10 per cent of the fares of those who tipped, or 5 per cent of the total fares. (R. 10.) On cross examination taxpayer testified that the typical fare was 50 cents for which the usual tip was 10 cents; that an 80 cent fare would bring a 10 cent tip; that the usual tip for a 30 cents fare was 10 cents to 15 cents; that the majority of passengers gave no tip if the fare were $1. (R. 27-29.) On redirect examination taxpayer testified that he received 10 to 20 cent tips on $1.80 fares, that he rarely received tips on $5 to $20 fares and that he carried some passengers on charge accounts who did not usually tip. (R. 31-32.)

Taxpayer's testimony showed only that tips customarily varied from 0 to 50 per cent of the fare. He gave no indication of the approximate number of trips at the respective fares, or the number of charge trips. Apart from taxpayer's bald assertion that the tips received were approximately 5 per cent of the gross fares, there was nothing in his recitation of basic facts upon which the Tax Court could have concluded that the determination of the Commissioner was erroneous.

One other witness testified for the taxpayer, Mr. Philip Davis, a cab driver and representative of an organization of 350 cab drivers formed to deal with income tax problems of the group. (R. 35.) Upon being asked what he considered a fair percentage basis in determining the relationship between tips received by cab drivers and the fares of those passengers who tipped, he replied as follows (R. 38):

> Oh, I don't know. I would more than likely concur to Mr. Roberts' estimate on that, about 10 per cent. It would in this matter. I might make an explanation to that, that you get your ten, occasionally your quarter, on your short trips or on your long trips, but you wouldn't get your ten per cent proportionately on a two or three dollar trip, basing it on a 50-cent estimate of a dime.

The unsatisfactory nature of this nebulous adoption of the taxpayer's testimony is manifest.

Three witnesses testified for the Government on this issue. Mr. Orville Richardson, personnel director of the Yellow Cab Company of Los Angeles, and previously traffic superintendent, starter, and taxicab driver, testified that he kept records of his tips for the years 1941, 1942, and part of 1943 and 1946, and the tips average "at least" 10 per cent of the gross fares.

(R. 49.) He testified further that a 10 per cent average of tips to gross bookings is a "conservative" estimate of tips received by the average cab driver who drives the Yellow cab. (R. 49-50.) Although it is true that Mr. Richardson did not drive taxicabs during the greater part of 1943, the testimony of taxpayer's own witness, Mr. Davis, indicated that "tips" were if anything more liberal in 1943 than during the prior years. (R. 36.)

Mr. Lloyd E. Bryson, a cab driver of 17 years' experience and a driver for the Yellow Cab in the year 1943, testified that 10 per cent would be a fair and reasonable estimate of the percentage of tips to gross bookings. (R. 53.)

Mr. Robert Hendry, a driver of Yellow cabs in Los Angeles for 16 years, testified that 10 per cent is a "very reasonable" estimate of the percentage of tips to gross fares. (R. 56.)

The Tax Court apparently chose to believe the disinterested testimony of the Government's witnesses, all of whom worked for the same taxicab company and in the same general area as the taxpayer.

Under Section 36 of the Act of June 25, 1948, Public Law 773, 80th Cong., 2d Sess., the scope of review exercised by the United States Courts of Appeals over decisions of the Tax Court shall be the same as that exercised over "decisions of the District Courts in civil actions tried without a jury". That being so, Rule 52(a), Rules of Civil Procedure for the District Courts, will apply. Rule 52(a) provides in part: "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses". It is manifest that the findings of the Tax Court in the instant case are not clearly erroneous, especially when

regard is given to the opportunity the Tax Court had to judge of the credibility of the witnesses.

There was nothing in the testimony of the taxpayer to support his contention that tips received by him in 1943 were less than the amount determined by the Commissioner apart from his unsupported assertion to that effect. He kept no records. His testimony as to amounts customarily given as tips for various fares provided no basis for the conclusion that the Commissioner's determination was erroneous. The unsatisfactory nature of the testimony of Mr. Philip Davis has already been noted. The testimony of both witnesses was, of course, subject to the possibility of being colored by self-interest.

The three witnesses who testified for the Government, on the other hand, were disinterested. If anything, their interests were adverse to the Government's. Due to the fact that they had worked in the same general area as the taxpayer and for the same taxicab company, they were eminently qualified to testify on the matter involved. One of the three, Mr. Orville Richardson, was the only witness to testify who had actually kept records of tips received. Indeed, it is difficult to see how the Tax Court could have arrived at any other conclusion. Since it is apparent that the findings of the Tax Court are not clearly erroneous, they may not be disturbed on appeal.

CONCLUSION

Tips received by the taxpayer were simply a form of compensation for services properly rendered, and, as such, constitute taxable income. In the light of taxpayer's failure to keep records of his tips, and in view of the fact that there was abundant evidence to support the Tax Court's finding that tips received by the tax-

(R. 49.) He testified further that a 10 per cent average of tips to gross bookings is a "conservative" estimate of tips received by the average cab driver who drives the Yellow cab. (R. 49-50.) Although it is true that Mr. Richardson did not drive taxicabs during the greater part of 1943, the testimony of taxpayer's own witness, Mr. Davis, indicated that "tips" were if anything more liberal in 1943 than during the prior years. (R. 36.)

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ONCLUSION

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payer were conservatively 10 per cent of his gross fares in 1943, as determined by the Commissioner, the finding of the Tax Court should be upheld and the judgment of the Tax Court should be affirmed.

Respectfully submitted,

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OCTOBER, 1948.

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